DRAFT: February 9, 2004

Outline of Comments re "Uncommitted Entry"

1. The basic approach suggested by simple intuition and many cases

    a. Assess competition by defining the market and identifying that firms that sell in the market

    b. Consider entry of other firms as a constraint on anticompetitive effects

2. Some cases in 1980s eroded this approach by taking supply elasticity into account in defining the market

3. Merger Guidelines refine the analysis by specifying that markets be defined on the basis of demand, distinguishing between "uncommitted" and "committed entry," and including only the former in the market.

    a. "Uncommitted' entrants are not presently selling in the market, but

        i. would enter within a year in response to a SSNIP, and

        ii. could enter without incurring "significant sunk costs"

    b. because uncommitted entrants have no actual sales in the market, their shares must be calculated on the basis of capacity

4. Practical problems with the concept of "uncommitted entry"

    a. The idea of uncommitted entry potentially adds to the issues to be explored, i.e., the need to inquire whether the sunk costs are substantial and whether entry would take place in a one year, but uncommitted entrant are likely to be rare

        i. there are almost always sunk costs, especially if opportunity costs are taken into account (in other words, the fact that a firm is not presently selling in the market presumably says something)

        ii. the concept probably applies only to unbranded products or services that can be manufactured or provided with existing facilities that are used for other products or services and can be switched with no capital investment

    b. Analysis of the merger is not shortened, even if an uncommitted entrant is identified

i. Even if a firm is deemed to be an uncommitted entrant, not all of its capacity is necessarily deemed to be in the market; to the contrary, the Guidelines exclude from the market capacity that is "committed or so profitably employed outside the market" that it would not enter in response to a SSNIP; in effect, the share attributed to the uncommitted entrant is a prediction of its likely actual entry

ii. The fact finder thus must make the same inquiry about both uncommitted entrants and committed entrants -- how much would likely enter and when -- in light of the costs of entry, the incentives for entry and the opportunity cost of entry

c. Not surprisingly, therefore, our experience suggests that the notion of uncommitted entry neither streamlines the process nor enhances the analysis

i. merger analysis starts with assessment of candidate market and estimation of shares and HHIs based on firms presently selling in market

ii. then, the analysis shifts to whether prospect of entry ameliorates competitve concerns

iii. categorization of potential entrants as uncommitted or committed does not shortcut this process

iv. nor does it materially affect the substantive analysis

1. if merger outcomes turned largely on HHIs, the exercise of determining whether an entrant should be taken into account in that calculation (i.e., refining the HHI estimate) might be valuable

2. but HHIs are only a starting point in an inquiry that is ultimately aimed at analyzing the likely competitive effects; indeed, recent DOJ/FTC data suggest that HHIs have limited utility in predicting enforcement decisions

3. although the discussion in the Guidelines of uncommitted entry usefully directs attention to issues of sunk costs and the timing of entry, the uncommitted/committed dichotomy adds little to the competitive effects analysis

5. Theoretical problems with the concept of "uncommitted entry"

a. Any effort to put facts into one category or another runs the risk of inducing a focus on category criteria (and resulting exegesis and lore) that comes to have little relation to the substantive purpose initially sought to be served by the categories

b. The concept suggests a false dichotomy, or at least excessive formalism, in the distinction between uncommitted and committed entry, when they are inevitably just points on a continuum

c. Problems regarding calculation of shares

    i. The reason for including uncommitted entrants in the market is to refine the assessment of competition in the market prior to the merger; market shares and HHIs are central to this assessment

    ii. The Guidelines set forth criteria for determining best basis for calculating shares

        1. Because they have no sales in the market, uncommited entrants' shares must be measured by capacity

        2. But capacity is optimal measure of shares of firms actually selling in the market only under certain rather uncommon circumstances

    iii. Therefore, inclusion of uncommitted entrants will often undermine assessment of market concentration as a starting point for analysis by either including firms whose shares are not comparable to the others' or by forcing use of suboptimal measures of market shares

d. The distinction between committed and uncommitted entry does not precisely reflect its purported purpose

    i. The reason for distinguishing between firms in the market and those that are only potential entrants is this

        1. Firms in the market are those that exert a present constraint on competition in the status quo ante or the premerger world; it is useful to identify those firms

            a. in order to ascertain whether the market is susceptible to competitive problems, and

            b. in order to understand at the outset of the analysis whether the merger may injure competition by eliminating an existing constraint on anticompetitive conduct in the market

        2. Other firms that are potential entrants matter to the analysis only to the extent that they would enter (and thus would begin to affect) the market in response to competitive harm caused by the merger;

they are thus appropriately considered at the competitive effects stage of the analysis

ii. The distinction between uncommitted and committed entry is an interesting typology but at best a crude proxy for the substantive factors it is supposed to illuminate

1. Even a truly uncommitted entrant might not exert a present constraint on entry if, for example, limit pricing is unnecessary because entrants know that incumbents could promptly lower prices and retain volume in response to imminent entry

2. A committed entrant might exert a present constraint on competition if entry could cause a permanent shift in volume (e.g., leapfrog entry by new and superior motion picture theater)

6. Suggested alternative to present distinction

a. Focus on two different material issues:

i. Are there potential entrants[1] that exert a present competitive constraint on the market, i.e., a present perceived entry or "wings" effect?

ii. What is the likelihood that new entry post-merger would ameliorate or prevent competitive harm from the merger?

b. To illuminate these issues, undertake the same basic inquiry regarding the likelihood of actual entry by all potential entrants-- under what circumstances, at what volume and over what time would the firm enter?[2]

c. Inquire as part of that inquiry whether the entrants exert a present perceived entry or "wings" effect

i. sunk costs are relevant to this inquiry but not necessarily dispositive

---

[1] For this purpose, the term "potential entrant" includes both firms not presently selling in the market and capacity that is owned by firms selling in the market but not presently used for sales in the market.

[2] In theory, a firms could exert a wings effect even if it is not also a potential actual entrant. But that would be the case only if the incumbents in the market were persistently ignorant of the actual unlikelihood of entry. It is not clear that the Guidelines need to take this possibility seriously.

ii. the competitive importance of the wings effect will probably reflect, e.g., the existing sellers' expectation about the volume of potential entry that is likely to enter; available capacity is a good proxy

d. When assessing the competitive effects of the merger, be mindful of whether wings effects are part of the story

i. determine whether wings effects are material to competition in the market preentry and, if so, whether the merger will eliminate a present competitive constraint

ii. pre-and post-merger HHIs calculated by including wings effect entrants are useful, but only as one small piece of the analysis